

CHAPTER 13

LENDER OVERSIGHT

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LENDER OVERSIGHT REVIEWS

All lenders should obtain a copy of SBA SOP 50-50-4(B), Loan Policy and Program Oversight Guide for Lender Reviews.

Beginning in the Year 2000, each District Office began reviewing their non-PLP lender's SBA Portfolio at least once within a 3-year cycle. The PLP lenders are reviewed every year by the PLP Review Team with occasional assistance from the District Office.

How are Lenders selected for review?:

All lenders, except PLP lenders, can be selected for a review in any given year to accomplish the District Office goal. In addition, any lender that falls below 4 or more of the Benchmarks MUST be reviewed that year even if they were reviewed the previous year.

Review Scheduling Priority:

District Offices must plan their review schedules according to the following priority system:

1. Lenders below the performance benchmark in 4 or more of the criteria must be reviewed that year.
2. Lenders below the performance benchmark in 3 of the criteria.
3. Lenders below the performance benchmark in 2 of the criteria.
4. Lenders below the performance benchmark in any one of the criteria.

Note: Different Benchmarks have been established for the 7(a) and 504 Loan Programs.

Benchmarks established for the 7(a) program:

1. Currency Rate: $\leq 70\%$

Percentage of loans that are 0 to 30 days past due in scheduled payments; deferments are not included even though these loans are technically current because deferred loans by their very nature have underlying problems that necessitated the deferment. Currency rates are based on the total outstanding (active) loan portfolio – PIFs and charge-offs are not included, but delinquent and liquidation loans are.

2. Delinquent Rate: $\geq 11\%$

Percentage of loans over 60 days delinquent including those in liquidation compared with total outstanding (active) loan portfolio; PIFs and charge-offs are not included.

Liquidation is included in the delinquency total to give a true picture of a lender's problem loans – it also recognizes that lenders have different means of classifying

severely delinquent accounts as being in liquidation, and when they are so classified.

3. Default Rate: $\geq 9\%$

Percentage of loans purchased compared with total loans disbursed by a lender, consisting of the outstanding (active) portfolio plus PIFs and charge-offs.

4. Liquidation Rate: $\geq 7\%$

Percentage of loans being liquidated ("In Liquidation" status) compared with a lender's total loans outstanding (active portfolio). Loans are generally classified "In Liquidation" when workout attempts have ceased and a lender begins enforced collection procedures to obtain recovery.

5. Loss Rate: $\geq 6\%$

(Charge-offs/write-offs) Losses will be calculated as a percentage of total loans disbursed, outstanding (active) portfolio plus PIFs and charge-offs. Losses are an important measure since a lender's currency rate may be high, giving a false picture of a healthy loan portfolio although the lender may have a high loss rate. Losses will be tracked on a cumulative basis (i.e., total losses on a lender's portfolio as a percentage of the total disbursements for all loans originated since fiscal year 1989), and subsequently on an annual basis by loan cohort (total losses by fiscal year compared with total loan disbursements for that fiscal year).

Benchmarks established for the 504 Program:

1. Portfolio Currency Rate: < 90 percent

Currency Rate: Loans that are 0 to 30 days current compared to the total active portfolio. (Sources: Colson, SBA)

2. Delinquency Rate: ≥ 5 percent

Delinquency Rate: Loans over 60 days delinquent, including loans in liquidation, compared to the total active portfolio. (Sources: Colson, SBA)

3. Default Rate: ≥ 9 percent

Delinquency Rate: Loans over 60 days delinquent, including loans in liquidation, compared to the total active portfolio. (Sources: Colson, SBA)

4. Liquidation Rate: ≥ 5 percent

Liquidation Rate: The balance of loans in liquidation compared with the total active portfolio. (Sources: Colson, Harris Trust, SBA)

5. Loss Rate: ≥ 3 percent

Loss Rate: The balance of loans charged off compared to the total dollar amount of loans funded. (*Sources: Harris Trust, SBA*)

Loan Selection:

Loans will be selected at random the day of the scheduled review. The team must review 20% of the lender's loan approval volume made during the previous complete fiscal year up to a maximum of 50, except in cases where the lender participates in multiple programs. In these cases, the review team must select an additional 5-10 loans from each program to supplement the existing sample.

The minimum number of loans that must be reviewed is five. Once the number of loans to be reviewed has been determined, the specific sample must be generated according to the following schedule. (If the lender will be reviewed for more than one loan program, the additional 5-10 loans for that program must also be distributed according to this schedule – as broken down below:

75% of the loans reviewed must be approvals from the previous complete fiscal year.

20% of the loans reviewed must be loans currently in liquidation (approved in any year, but not charged-off).

5% of the loans reviewed must be in active servicing (approved in any year, but not in liquidation).

Reporting:

Loan-by-Loan Review Sheet:

The review team will complete a Loan-by-Loan Review Sheet on each loan reviewed. The information on the Loan-by-Loan Review Sheets is entered into the computer system. Each question on the sheet requires a "Yes", "No" or "N/A" answer. Each "No" response reflects a deficiency on that loan. The lender is required to correct each deficiency as instructed by the review team. (See Appendix 13-A, sample Loan-by-Loan Review Sheet.) The scoring on the review sheet becomes part of the lender's final scoring.

Oversight/Policy/Controls

There is an additional form titled "Oversight/Policy/Controls" (see Appendix 13-B). The lender is required to answer the questions on this form. We will send this form to you when the review is scheduled. This form must be completed and given to the team at the time of the review. The lender's response to these questions becomes part of the final scoring process.

Summary/Recommendations:

In this section, the review team must summarize their findings and send the findings along with any corrective action recommendations to SBA Headquarters in Washington. The report is also shared with the lender.

Scoring:

The final score is automatically calculated and will provide a compliance rating based upon a 100-point, percentage-based scoring system. Following is the scoring grid.

1. 85 – 100. **Substantially in Compliance.** The lender is found to be “substantially” in compliance. No corrective actions are automatically required. The field, however, may still opt to require corrective actions. Lenders that have passed all five benchmarks and score in this range will be presented the “Excellence in SBA Lending” award.
2. 70 – 84. **Generally in Compliance.** The lender is found to be “generally” in compliance. Lenders scoring at this level may be placed by the field into a corrective action period.
3. 50 – 69. **Minimally in Compliance.** The lender is found to be “minimally” in compliance. Lenders scoring at this level must be placed by the field office into a corrective action period.
4. Below 50. **Non-Compliance.** The lender must be placed in an immediate corrective action period.

Unilateral Action:

Upon completion and documentation of the review, the District Office may take any unilateral action currently permitted by SBA policy for the lender’s respective program. This includes unilateral suspension actions. Each lender will be required to cure the deficiencies on each loan and report to the District Office within 30 days.

Corrective Actions:

In addition to any unilateral authority, current policy permits the field offices to undertake additional measures if deemed necessary. The District Office may take steps to assist the lender in an effort to improve performance in areas that the field office determines to be seriously inadequate, but do not pose an immediate and unacceptable level of risk. One suggested action is a 90-day corrective action period, a period during which the lender must demonstrate that steps have been taken to improve their performance and/or lower their proportional risk to SBA's portfolio.

Under these circumstances, the District Office must require the lender to submit an action plan, 3-pages or less, that details the specific actions that the lender will take to improve performance (training, new procedures, etc.). The field office may decline an action plan that it deems unacceptable. The lender has 30 business days from the date of its receipt of a review report requiring the submission of an action plan. District Offices may extend this period another 30 days at their discretion. If the lender does not submit an acceptable action plan within 30 business days of notification from the District Office and has not requested additional time to complete the plan, the District Office must recommend to the Associate Administrator of Field Operations suspension from the applicable program.

During a 90-day corrective action period, the District Office, at its option, may choose not to accept loans from the lender for ALP or CLP processing. However, the District Office must continue to accept and process the lender's loans during this period.

At the conclusion of the 90-day corrective action period, the District Office must review the lender's action plan and confirm with the lender that the initiatives outlined in the lender's action plan have been executed. The field must also verify that any performance goals set in the lender's action plan have been attained. If the District Office's review of the lender's efforts satisfies the District Office that the lender has taken steps to bring risk within acceptable parameters the District may choose to extend the corrective action period for another 90-days or declare the lender in compliance and cease further action.

If the District Office is not satisfied at the conclusion of the 90-day corrective action period that the lender has made significant progress, the District Office may extend another 90-day corrective action period or recommend suspension of the lender.

See Appendix 13-C for the most frequent errors found during lender oversight reviews. Establishing procedures and systems to avoid these errors will help the lender stay in compliance with SBA rules and regulations.

APPENDIX 13-A

SAMPLE LOAN-BY- LOAN REVIEW SHEET

SAMPLE LOAN-BY-LOAN REVIEW SHEET

PLEASE MAKE SURE THE REVIEW TEAM CAN MARK EITHER "YES" OF "N/A" TO EACH QUESTION. EVERY "NO" ANSWER DENOTES A DEFICIENCY ON THAT LOAN.

Lender Review System Version 3.00		Loan #1	Comments
	Processing/Forms/Eligibility/Credit Analysis		
1	Is the SBA application form (Form 4, 1244, 4L, Applicant Certification for <i>Express</i> loans, etc.) complete, signed and dated by the borrower?		
2	Is SBA Form 4-I (Lender's Application for Guaranty or Participation), 1244, or Form 4L complete, signed, and dated by the Lender?		
3	Are all required Form 912s (Statement of Personal History), or equivalent for <i>Express</i> , complete, signed and dated?		
4	Is SBA Form 1624 (Certification Regarding Debarment & Suspension), or equivalent, complete, signed and dated?		
5	Is SBA Form 1846 (Statement Regarding Lobbying) or equivalent, complete, signed and dated?		
6	Are personal financial statements present, complete signed and dated for all owners of 20% or more of the borrower, personal guarantors and others required?		
7	Are the required business financial statements present, complete, signed and dated?		
8	All application forms are dated prior to submission of application to the appropriate Loan Processing Center?		
9	Were size determinations correct and analyzed according to SBA policy (including affiliation determinations)?		
10	Did the loan file document that credit was not available elsewhere on reasonable terms?		
11	Was the personal resources test, applied and enforced according SBA policy?		
12	Was the nature of business of the small business concern eligible for SBA financing?		
13	Was the nature of business of the small business concern eligible for PLP/PCLP/ <i>Express</i> processing?		
14	Was this loan to a US citizen or eligible non-citizen?		
15	Does the business activity associated with the SBA loan demonstrate that it is NOT of a sexually prurient nature?		
16	Did the loan applicant(s) demonstrate no loss to the Government in all prior federal financial assistance received?		

Lender Review System Version 3.00		Loan #1	Comments
17	If applicable, were eligible passive company rules applied according to SBA policy?		
18	Was the purpose of the use of proceeds eligible?		
19	If the project involved the refinancing of existing debt, was SBA policy correctly applied regarding the eligibility of the debt refinanced?		
20	If the loan proceeds were used to acquire, build or renovate real property, did the loan meet SBA's policy requirements regarding occupancy percentage?		
21	If the loan involves a change of ownership was it eligible?		
22	If the loan is a piggyback loan, and is processed via PLP, is the first mortgage with another lender?		
23	If the loan finances real estate or is to a new business, and is processed via PLP, does it finance 90% or less of the project?		
24	If the loan involved a franchise, did the borrower have the power to control the franchise?		
25	Were you unable to detect any apparent conflict of interest related to the borrower on this loan?		
26	Were you unable to detect any apparent conflict of interest related to the lender on this loan?		
27	Did the new loan coupled with any other outstanding SBA loans meet the allowable loan program limits?		
28	Was the loan amount, percent of guaranty, maturity and interest of the loan consistent with SBA policy?		
29	Was repayment ability reasonably addressed using historical data, realistic projections, or other appropriate method?		
30	If outside resources were relied upon for any repayment ability, was this documented properly?		
31	Was the adequacy of working capital properly addressed?		
32	Was the adequacy of capitalization properly addressed?		
33	Was the management ability of the borrower properly addressed?		
34	Was the determination of collateral adequacy properly supported and calculated consistent with SBA policy(or for <i>Express</i> , consistent with lender's non-government guaranteed collateral requirements)?		
35	If the loan was not "fully secured", was SBA policy followed for obtaining additional collateral?		

Lender Review System Version 3.00		Loan #1	Comments
36	Was a credit investigation performed and documented in the loan officer's report?		
37	Is the information provided in the loan request to SBA consistent with the information contained in the lender's loan application file?		
	Due Diligence/Authorization/Closing		
38	Was the loan authorization constructed in accordance with the loan approval?		
39	Was the signature of the lender on the authorization?		
40	Was the correct version of the loan authorization used and were any amendments to the boilerplate approved by SBA(or for Express was the SBAExpress Loan Authorization, current version used)?		
41	Was the borrower's identification and legal name consistent between the authorization and the lender's documents?		
42	If the authorization required guarantees, were they prepared and executed according to SBA policy and the authorization?		
43	If required, was the borrower's injection verified (must verify for 504/Low Doc as coming from eligible sources)?		
44	If SBA's guaranty funded a construction loan were the proper construction requirements met?		
45	Do the terms of the Note match the authorization?		
46	Does the Note have the proper signatures?		
47	Do the lien instruments, including but not limited to Deed(s) of Trust or Mortgage(s), have the proper signatures?		
48	For real estate collateral, is SBA in the appropriate, perfected lien position?		
49	If personal property was taken as collateral, is SBA in the proper, perfected lien position?		
50	If personal property was taken as collateral, was there an itemized list of personal property over \$500, taken as collateral? (Applicable after 6/98)		
51	If an appraisal and/or an environmental assessment was required, was it obtained and did it meet the conditions of the requirement?		
52	Were specified insurance requirements met?		
53	When required according to SBA policy, did the loan file document verification of financial statement data via tax transcript procedure?		

Lender Review System Version 3.00		Loan #1	Comments
54	Are all applicable SBA Form 159 (Compensation Agreement) statements complete, signed and dated?		
55	Was the SBA Form 1050 Settlement Sheet or (504) Servicing Agent Agreement completed correctly and in accordance with the authorization?		
56	If a 7(a) loan, was the guaranty fee paid, in the correct amount and submitted within the proper time-frame?		
57	If required, were any standby agreements signed properly and in order?		
Servicing/Liquidation			
58	Were the insurance requirements up to date?		
59	Were the financial statements current or can the lender document efforts to secure timely financial statements?		
60	Were servicing actions for this loan properly documented, supported and within the scope of the lender's unilateral authority?		
61	Did the lender have prior written SBA approval for servicing actions outside the scope of the lender's unilateral authority?		
62	Did SBA receive proper notification of all servicing/liquidation actions taken as required?		
63	If a liquidation case, was the liquidation plan, including the risk management form developed and submitted in a timely basis?		
64	If a liquidation case, were litigation legal fees pre-approved by the field office?		
65	If the loan was purchased, were the fees submitted by the lender for liquidation/servicing customary and reasonable?		
66	If a liquidation case, were status reports submitted on a timely basis as required?		
67	If a liquidation case, were alternatives explored to avoid the acquisition of collateral? (If alternatives are documented, you MUST answer YES even if the title was acquired).		
68	If a liquidation case, were current appraisals used by the lender to evaluate collateral?		
69	If a liquidation case where title of property was taken, was an environmental review done prior to the acquisition of title?		
70	If a liquidation case, did the file reflect that workout attempts were explored where possible prior to commencement of liquidation?		
71	If a liquidation case, did the lender pursue recovery from guarantors/obligors?		

Lender Review System Version 3.00		Loan #1	Comments
72	If a completed liquidation case, was the wrap-up submitted within the time frame to SBA?		
73	If a liquidation case, did the lender receive prior written approval for actions outside the scope of unilateral authority?		
74	If a liquidation case, were required site visits performed in a timely manner?		
75	If a liquidation case where there has been a purchase, have any funds collected been remitted to SBA in a timely fashion?		

APPENDIX 13-B

SAMPLE OVERSIGHT/POLICY CONTROLS FORM

SAMPLE OVERSIGHT/POLICY/CONTROLS FORM

LENDER'S MANAGEMENT STAFF IS REQUIRED TO ADDRESS THE QUESTIONS ON THIS FORM

Lender Review System Version 3.00		Response	Comments
Oversight/Policy/Controls			
76	Does the lender have a <u>written</u> statement of policy?		
77	Does the lender have a <u>written</u> commitment to make loans to all qualified applicants regardless of race, creed, nationality, or gender?		
78	Does the lender have a normal geographic lending area and does the lender document under what circumstances they may provide lending outside this area?		
79	Does the lender have a <u>written</u> policy of lending authority delegations?		
80	Does the lender's <u>written</u> policy describe the fees that may be charged to the borrower?		
81	Does the lender have a <u>written</u> policy for their portfolio review process?		
82	Does the lender's <u>written</u> policy outline what collection actions may be taken against borrowers who do not make timely payments.		
83	Did the lender document its procedure to ensure that loans are approved and authorizations signed by officers with the appropriate authority?		
84	Did the lender document its procedure to assure that required closing documents are obtained? (If the lender makes loans in more than one state, the procedure must include allowances for state variations in the required documents).		
85	Did the lender document its process for ensuring that items required after closing are collected?		
86	Did the lender document its method of safeguarding collateral documents in the lender's care?		
87	Does the lender maintain a schedule of any field visits required and document loan files when visits are completed?		
88	Does the lender have a process for updating UCC filings, financial statements and insurance requirements? (Tickler system, etc.)		
89	Does the lender have access to counsel available for processing, closing and servicing advice? (If the lender lends in more than one state, the lender must have access to counsel in each state).		

Lender Review System Version 3.00		Response	Comments
Oversight/Policy/Controls			
90	Did the lender document that it has the resources available for proper servicing and liquidation (if applicable) throughout the geographic area in which the lender makes loans?		
91	Did the lender document its process to setup regular reviews of seriously delinquent loans?		
92	Does the lender maintain its loan files in a consistent, orderly and accessible manner?		
93	Is the lender's <u>written</u> policy consistent with SBA policy?		
94	Does the lender have a marketing plan to utilize and promote SBA loans?		
95	Does the lender support agency initiatives?		
96	Did the lender originate the minimum number of loans necessary for program participation? (Program specific)		
97	Did the lender document its procedures to ensure that required forms are with their SBA applications?		
98	Did the lender document its procedure to ensure that SBA credit and eligibility requirements are complied with?		
99	Did the field office approve any contracts the lender has with service providers?		
100	Did the lender document its procedure for ensuring that only allowable fees are charged to the SBA borrower?		
101	Did the lender document its process for ensuring routine portfolio reviews and borrower contact on SBA loans?		
102	Did the lender document its process for ensuring timely filing of Loan Status Reports and the correction of submission errors?		
103	Does the lender document its process to ensure proper notification to SBA of servicing/liquidation actions taken?		
104	Does the CDC document the number of jobs created/retained two years after the loan was disbursed?		
105	Did the lender document its training procedure for staff involved in SBA financing?		

APPENDIX 13-C

FREQUENT LENDER OVERSIGHT REVIEW ERRORS

FREQUENT LENDER OVERSIGHT REVIEW ERRORS

The following are some of the typical problems we have found during our Oversight Reviews:

- **NUMBER ONE PRIORITY – PLEASE ORGANIZE YOUR FILES**
APPLICATION SECTION
LOAN CLOSING SECTION
SERVICING SECTION
LIQUIDATION SECTION
- **MUST FILE A UCC-1 WITH CLERK OF COURT WHEN TAKING FIXTURES AS COLLATERAL.**
- **MUST OBTAIN A UCC-11 POST CLOSING SEARCH FROM THE STATE AND COUNTY, AS APPLICABLE**
- **EXPIRED UCCs – (SET UP A TICKLER SYSTEM)**
- **MUST OBTAIN HAZARD INSURANCE ON BUSINESS ASSETS INCLUDING PERSONAL PROPERTY**
- **MUST MAKE SURE THERE IS HAZARD INSURANCE ON PERSONAL RESIDENCES SHOWING LENDER AS A LOSS PAYEE/MORTGAGEE**
- **ALL HAZARD INSURANCE POLICIES MUST REFLECT MORTGAGEE CLAUSE AS “WILL PAY MORTGAGEE REGARDLESS OF ACTS OF MORTGAGOR”**
- **EXPIRED HAZARD INSURANCE POLICIES**
- **FAILURE TO OBTAIN PROPER DOCUMENTATION THAT COLLATERAL IS/IS NOT LOCATED IN A FLOOD ZONE, INCLUDING BUSINESS PERSONAL PROPERTY AND RESIDENTIAL REAL ESTATE**
- **LIFE INSURANCE ASSIGNMENTS WITH ACKNOWLEDGEMENT FROM LIFE INSURANCE COMPANY**
- **CASH INJECTIONS – MUST HAVE PROOF AND PROOF MUST BE DATED PRIOR TO THE FIRST LOAN DISBURSEMENT. NOTE: AN AFFIDAVIT SIGNED BY THE BORROWER/GUARANTOR WILL NOT SUFFICE**

- **DO NOT DEPEND ON YOUR CLOSING AGENT TO OBTAIN THE REQUIRED LOAN CLOSING DOCUMENTS. AUTHORIZATION. MAKE SURE YOU HAVE THE REQUIRED DOCUMENTS FROM THE BORROWER PRIOR TO LOAN CLOSING**
- **RETAIN PROOF OF ALL LOAN DISBURSEMENTS. NOTE: AN AFFIDAVIT SIGNED BY THE BORROWER WILL NOT SUFFICE.**
- **PROVIDE SBA WITH A 90 DAY STATUS REPORT ON ALL LOANS CLASSIFIED “IN LIQUIDATION” STATUS**
- **SOLICIT FINANCIAL INFORMATION FROM BORROWERS/GUARANTORS ON AN ANNUAL BASIS AS STIPULATED IN THE AUTHORIZATION AND LOAN AGREEMENT**
- **VERIFY ANNUAL PROPERTY TAXES ARE PAID ON REAL ESTATE COLLATERAL**
- **GUARANTY FEES MUST BE PAID TO SBA BY THE LENDER NOT THE BORROWER.**